Federal Order #32 Hearing Statement
Docket No. AO-313-A44, DA-01-07

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Kansas City, Missouri

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Prairie Farms Dairy, Inc.

Exhibit 15
11/14/2001

My name is Gary Lee. I am employed by Prairie Farms Dairy, Inc. as the Vice President of Marketing and Procurement.

Prairie Farms is a dairy farmer cooperative headquartered in Carlinville, Illinois. Through direct ownership and joint ventures we operate 14 milk processing plants that are regulated under Order 1032.

The plants operated by Prairie Farms include:

1. Carlinville, Illinois; fluid milk
2. Olney, Illinois; fluid milk
3. Peoria, Illinois; fluid milk and fruit juice
4. Quincy, Illinois; fluid milk
5. Granite City, Illinois; fluid milk and extended shelf life products (ice cream mix, half & half, whipping cream, etc…)
6. Carbondale, Illinois; soft cultured products (cottage cheese, sour cream, dips)
7. St. Louis, Missouri; fluid milk, soft cultured products, ice cream, fruit juice

Prairie Farms also operates 6 unregulated plants in the area covered by Order 32, they include:

1. Quincy, Illinois; soft cultured products (cottage cheese, yogurt, sour cream)
2. Springfield, Illinois; bulk ice cream mix
3. Decatur, Illinois; ice cream
4. O'Fallon, Illinois; ice cream, bulk ice cream mix
5. St. Louis, Missouri; butter, anhydrous milkfat
6. Brentwood, Missouri; frozen ice cream novelties

Of these 6 plants, only Quincy, Illinois and Decatur, Illinois receive producer milk on a regular basis. You will note that we have 2 plants in Quincy, Illinois. They are 6 blocks apart. You will also note that we have 2 plants in St. Louis, Missouri. They are approximately 2 miles apart.

A joint venture with Dairy Farmers of America called Roberts Dairy operates the following plants pooled on Order 32:

1. Iowa City, Iowa; fluid milk
2. Des Moines, Iowa; fluid milk
3. Omaha, Nebraska; fluid milk, sour cream, dips, dispenser bags of half & half for food processors, fruit juices
4. Kansas City, Missouri; fluid milk and fruit juices

A second joint venture with Dairy Farmers of America called Hiland Dairy operates the following plants pooled on Order 32:

1. Wichita, Kansas; fluid milk, cottage cheese, yogurt
2. Norman, Oklahoma; fluid milk, sour cream, dips
3. Chandler, Oklahoma; fluid milk, cottage cheese, ice cream

Hiland Dairy has 3 other fluid milk processing plants located in Springfield, Missouri, Fayetteville and Ft. Smith, Arkansas, that are regulated by Order 7.

A third joint venture with Dairy Farmers of America operates a fluid milk processing plant in Evansville, Indiana regulated by Order 5.

The joint ventures are structured so that Prairie Farms oversees day to day operations while DFA arranges for the milk supply. Therefore, my testimony will not go into milk supply issues for the joint ventures.

One point that I do want to emphasize however is that none of the above listed plants are engaged in manufacturing hard products such as cheese and powdered milk. We are not trying to support manufacturing plants in areas with a deficit milk supply. The butter plant in St. Louis, Missouri uses only bulk cream, much of it distressed, and scrap butter to manufacture its products.

As you can see, we have a considerable presence on Order 32 and what happens on Order 32 is very important to our members.

In October 2001, Prairie Farms had total membership of 797 producers with a total production of 88.5 million pounds of milk. Milk from 620 of those producers was pooled on Order 32. This amounted to approximately 68.9 million pounds of milk.

The producers whose milk is pooled on order 32 are all located in Illinois, the southeastern one-fourth of Iowa and the eastern half of Missouri. Milk from all of our members located in these 3 states is pooled on Order 32 or is not pooled. Our other producer members are located in Indiana, Michigan and Ohio. Their milk is pooled on Order 33 at plants that we own and operate in Ft. Wayne, Indiana, Anderson, Indiana and Galesburg, Michigan.

We also purchase supplemental supplies of milk from other cooperatives at our Order 32 Prairie Farms plants. These purchases take place every week of the year and come from producers located in Illinois, Missouri, Iowa, Minnesota and Wisconsin. These purchases amount to about 30 percent of the milk processed at our plants.

We do not participate in any pooling units with any other entity on Order 32. We do not engage in any pooling of milk from another entity for a fee on Order 32. We do have a pooling unit made up of our plants located in Carlinville, Illinois; Olney, Illinois, Granite City, Illinois; Peoria, Illinois; Quincy, Illinois and Carbondale, Illinois. The cultured product plant in Quincy, Illinois is currently not part of this unit. If the statistical uniform price gets substantially below the cost of Class 2 milk (order & over order premium), the Carbondale, Illinois plant may soon be removed from the unit.

At this time, I would like to speak in support of proposals 1, 2, 3, 4 and 5. I may ask to speak in support of proposals 6 and 8 later in this hearing.

I do not want anything in this testimony to be regarded as criticism of those involved in the order reform process. They were given a difficult task by Congress with fairly narrow parameters and they carried out that task to the best of their ability based on the situation at that time. However, we feel that dairy farmers located in the states where we have members associated with Order 32, especially Illinois and Missouri, have fared very poorly under order reform.

We operate in an area that is a deficit milk production area virtually everyday of the year Yet Order 32 has been written as if its main purpose was to allow for pooling milk rather than serving Class 1 and Class 2 handlers. It is perhaps the most loosely written of all orders. A case in point, if order provisions are used to the maximum, one pound of direct ship milk delivered to a pool distributing plant can pool up to 15 more pounds of milk.

Having said that, I do not want to go back to what we had prior to January 1, 2000. The orders that existed in this area prior to reform were written so tight that pooling of milk beyond basic Class 1 needs was difficult. This was especially true of Orders 32 and 50.

Almost every year in the late summer and fall, we had to buy considerable quantities of other order milk to cover our needs after we had exhausted the milk available from our regular supplemental suppliers.

At the same time, every few years during periods of high production we would have to petition the department for temporary relief from these high-shipping percentages. This would often occur in December and January and was necessary to prevent inefficient and uneconomical movements of milk to meet pooling standards. The way Order 32 is now written, it allows for efficient pooling of milk and we support that, to a point.

While the old system was not perfect, it did allow for a decent return for those supplying milk to the lower Midwest on a regular basis. The uniform price was usually high enough to attract milk from the upper Midwest and yet keep us competitive with markets located below the Ohio River and east of the Wabash River. That is now not usually the case.

Milk usage at the above listed Prairie Farms plants has grown steadily in recent years. That is not uniformly true at all plants, but is true in total. At the same time the available supply of milk in the 3 states where we currently procure milk for our Order 32 plants has been flat or declining. Exhibit ______ Table 1 shows milk production by quarter form 1991 to the present in Illinois, Missouri and Iowa to illustrate this point.

Our producer numbers and member milk production are both currently lower than last year. We are faced with the dilemma of our business growing, but the nearby supply of milk not necessarily growing. Also, all dairy farmers in our procurement area may not want to be members of Prairie Farms.

As a result, we have become increasingly dependent on the upper Midwest for supplemental supplies of milk. We feel that those cooperatives serving this market deserve a better return for doing so or they might seek other markets for their milk.

For many years, milk-processing plants located in downstate Illinois and St. Louis, Missouri have depended on milk from dairy farms located in the southern one-third of Illinois and the eastern one-half of Missouri for a large portion of their milk supply. Milk production in those areas has been flat or declining as mentioned earlier.

Since January 1, 2000, the statistical uniform price for an Order 32 plant located in this area has not always been high enough to compete with plants pooled on Order 5 and Order 7. Producers located in southern Illinois or in southeast Missouri can switch to markets on Order 5 or Order 7 and get a higher price for their milk with little or no additional hauling cost. This is happening regularly.

Exhibit ____ Table 2 shows a comparison of statistical uniform prices for the Base Zone of Order 32, the Base Zone of Order 30, Order 5 zoned back to Evansville, Indiana and Order 7 zoned back to Murray, Kentucky. Evansville, Indiana and Murray, Kentucky were used because they represent the closest markets on those orders for a dairy farmer located in southern Illinois or southeast Missouri.

Exhibit _____, Table 3 shows the distance from several current shipping points in the upper Midwest to cities where we have plants located. That same table shows the distance from these locations where we have plants to the cities mentioned earlier in Order 5 and Order 7. The point of this table is to show that we have to rely on supplemental milk supplies that are not adjacent to plants in the Base Zone of Order 32. At the same time, dairy farmers in southern Illinois or southeastern Missouri located near our plants have fairly easy access to those markets on Orders 5 and 7.

Exhibit _____, Table 4 shows the approximate hauling cost to transport milk from the upper Midwest to the Base Zone plants on Order 32 and the approximate cost to transport the same load from those Order 32 plants to nearby markets on Orders 5 and 7.

The point of this is to show that the return under the order to ship milk from the upper Midwest to the lower Midwest will not cover the cost of hauling that milk. Many of those pooling milk on Order 32 may be doing so because of the return gained from pooling milk on the order, not from serving the market. Was this the intent of Order Reform?

For the first few months of 2000, the statistical uniform price on Order 32 was high enough to provide a decent return to an upper Midwest supply serving the market with a portion of their milk pooled on the order. At the same time, an Order 32 plant could compete fairly well with markets on Orders 5 and 7.

As some organizations became more adept at "riding" Order 32 with excessive supplies of milk combined with the low Class 3 price, this is no longer true. As the Class 3 price improved in 2001 that problem eased somewhat, but with the recent decline in the cheese market we will probably soon be back to this price distortion.

Let me provide two examples to show why we feel this is a problem:

1. In August, September and October of 2001 we exhausted the supplemental supplies made available to us by our other cooperative suppliers. We had to seek additional supplies of milk. In August, we purchased 7.91 million pounds of milk and had to pay $225,000 over regular announced prices and over order premiums. In September we purchased 5.95 million pounds of milk and paid additional premiums of $152,000. Most of this milk came from supplies already pooled on Order 32. However, because of current pooling standards, these suppliers did not have to ship the milk unless they extracted a "give up charge" from us. We had to pay a premium to purchase milk that should have

been available as part of normal supplies. And yet, Class 1 utilization on Order 32 never got above 30 percent in these months.

Something is wrong with a system that enables suppliers on low Class 1 utilization orders to "extort" money from handlers for milk already pooled on the order to meet basic Class 1 needs.

2. The fluid processing plant in St. Louis, Missouri for many years received a high percentage of its milk supply from Dairy Farmers of America or predecessor organizations. DFA approached us in the summer of 2001 and said that unless we paid a substantial premium, above regular over order premiums, to them they could not provide that plant with its regular milk needs beginning August 1, 2001.

DFA took this step because they said they had opportunities to shift the milk going to this plant to markets on Order 5 and/or Order 7 and get a significantly higher return.

When we approached several other cooperatives with milk already pooled on Order 32 about supplying this plant at order prices plus the announced over order premium, they all declined.

These 2 examples show the point we are trying to make. The return on Order 32 is currently not high enough to attract milk to Base Zone plants without substantial over order premiums. At the same time, the return in the Base Zone is not enough to keep nearby milk supplies from seeking markets on Order 5 or Order 7.

If the department feels that milk should flow north to south, they have created a problem in southern Illinois and eastern Missouri. Producer milk located in this area is trying to go south, but northern milk supplies do not want to flow into the area.

Also, let me add that a north to south flow of milk can come in packaged form as well as raw bulk milk. Some midwestern processors are well positioned to supply the dairy product needs of consumers in the southeast.

To those who say that we will just have to raise the over order premium even more, we would respond that if over order premiums are what move milk, then are the orders really working and if they are not working, why do we need them? However, Exhibit ____- Table 5 shows that over order premiums in the Order 32 area are similar to or higher than those in nearby markets.

We want to emphasize that we do not want anything we propose at this hearing to harm producers on adjacent federal orders. However, an examination of data provided by the Order 32 Market Administrator shows what we are talking about. The list of cooperatives and supply plants currently pooling milk on Order 32 shows several entities that had no association with this Order when it was formed on January 1, 2000. We have no problem with them being part of the order if they are here to serve the market. Our fear is that they were drawn here by the returns from pooling milk on Order 32, not serving Order 32 handlers. If we are wrong, hopefully those organizations will use this hearing as a forum to prove that.

The amount of producer milk pooled on Order 32 has increased considerably since January 2000. The amount of milk used in Class 1 has remained relatively stable. The amount of milk used in Class 3 has increased in similar proportion to the increase in total producer milk.

This has resulted in a no win situation for Prairie Farms members. The increase in producer milk and Class 3 utilization has lowered the statistical uniform price to our members. At the same time, this increased producer milk is not readily available to us at announced prices (order and over order premium), to serve our plants as a supplemental supply.

To those who oppose what we are proposing here and say that we will merely transfer our problem to another order, show some good will. Offer some of the milk that you are currently pooling on Order 32, but not serving the market with to Class I handlers at announced local prices. Handlers in the Base Zone of Order 32, especially those in St. Louis and points south would especially be interested in hearing from you.

Order provisions that are more conducive to pooling milk rather than serving the market should take place in areas of surplus, not deficit production. We urge the department to grant the changes that we are seeking with proposals 1, 2, 3, 4, and 5.

Proposals 1, 2, 3, 4 and 5 are a good start at trying to alleviate the supply dilemma that we face. The request in proposal 1 to no longer allow shipments to other order plants to help qualify a supply plant would correct a glaring shortcoming in Order 32.

Proposals 1, 3 and 5 would require shipping performance every month of the year. The performance would be at a level that should be tolerable to any organization concerned about the best interest of the order.

To summarize what we are trying to say, it is our feeling that producers located in large areas of Order 32 have received serious financial harm with the way Order 32 has worked since January 1, 2000. The return for continuing to serve the market that they have served for many years has been lowered without justification. They are faced with choices that many find unpleasant. They can continue to ship to their traditional market at reduced or even negative returns. They can switch to a potentially better, but unfamiliar market or they can discontinue dairying. We do not want to build a wall around this area. In fact quite the opposite is the case. We need adequate reserves of milk pooled on this order, but those pooling this milk should be expected to serve the market.